

### ***Executive Summary:***

- *The Puget Sound Region continues to outperform the nation.*
- *Bellevue home prices have rebounded much faster than the nation.*
- *Employment in the region and in Bellevue has also fared better than the nation during and since the Great Recession.*
- *Overall, the City's forecast assumes a modest recovery of tax revenues over the next few years.*
- *Risks:*
  - *Global/National: Ukraine, China, Europe, and Political Gridlock.*

### **Economic Outlook:**

As 2013 closes, the City's revenue collections show the recovery continues on a slow and steady path. Nationally, unemployment has continued to decline, which will spur demand and wealth-generating activities. Economists are predicting the recovery to slowly pick up pace in 2014 and 2015.

#### The State of the Recovery:

The next step beyond recovery from an economic event such as the Great Recession is, traditionally, expansion. The economy, as reflected in the Gross Domestic Product (GDP), hit bottom in 2009, and it regained all of the ground lost within just two years in both real and nominal dollars. Other measures of economic health, such as unemployment and home values, have yet to reach former peaks.

Despite several stumbling blocks, the United States economy has continued to grow steadily since the end of the recession. However, if not for internal factors such as political wrangling, the economy would have grown at a more brisk pace. One of the biggest casualties of the political problems is lowered consumer and business confidence, which creates economic uncertainty.

#### Global and National Risks on the Horizon

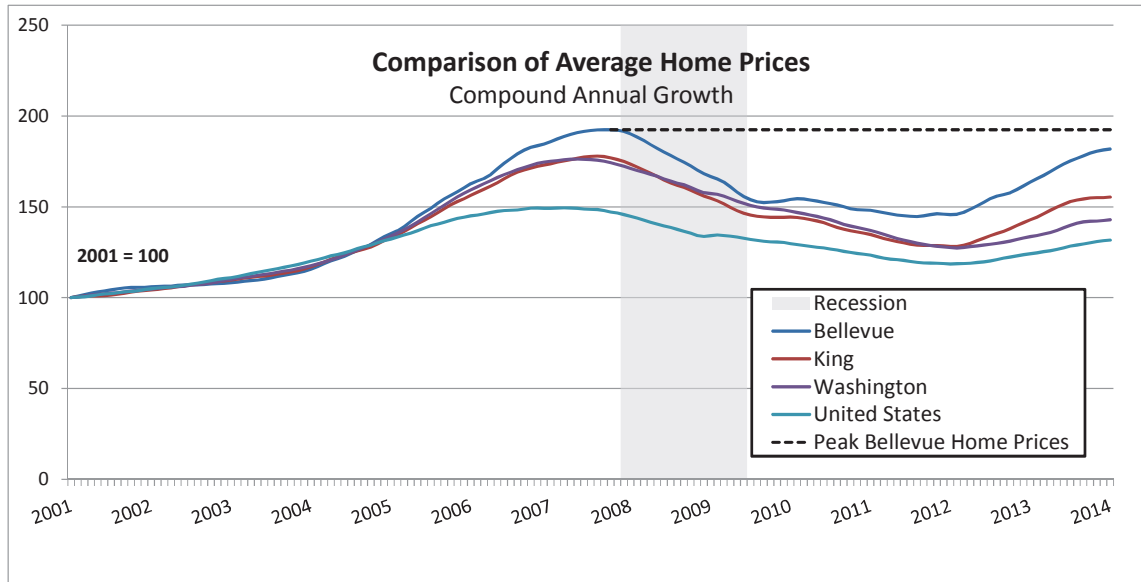
- **Trouble in the Ukraine.** As trouble unfolds in Ukraine, world markets will certainly be affected by the geopolitical implications of an East/West conflict. Ukraine is a significant exporter of grains and is the main conduit of natural gas to Western Europe from Russia.

- China's economic slowdown. China's economy has weathered the Great Recession better than most other countries, and in the global economy has helped others, including the U.S., by providing much-needed consumer and business demand. China's slowdown will be felt around the world and in the U.S.
- Stagnation in Europe. Europe has climbed out of recession, but growth remains weak.
- Continued Sovereign Debt problems in the European Union. Currently Italy and France are on a European Union watch list.
- Domestic Political Gridlock. The lack of agreement has diminished, to some degree, but political stalemate continues to be a real risk.

### Local Economy:

Locally the economy has fared better than the nation as a whole, but that is in large part due to companies such as Amazon and Boeing. Amazon continues to expand its operations and Boeing recently selected Everett for the latest 777 wing manufacturing facility. Amazon continues to eat up office space and has a new headquarters building planned in South Lake Union that will be able to accommodate upwards of a thousand employee (Source: Global Insight). The impact of the Boeing decision cannot be minimized, especially with the \$700 million in contract bonuses Boeing will pay to the machinist union members. Local economist Dick Conway of the Puget Sound Economic Forecaster suggests that, if Boeing was factored out of the region's economy, the region would have performed only as good as the national economy. Even though Boeing does not have a significant presence in Bellevue, Boeing and Amazon are important to the local economy because their employees live and spend their money in Bellevue's many retail stores.

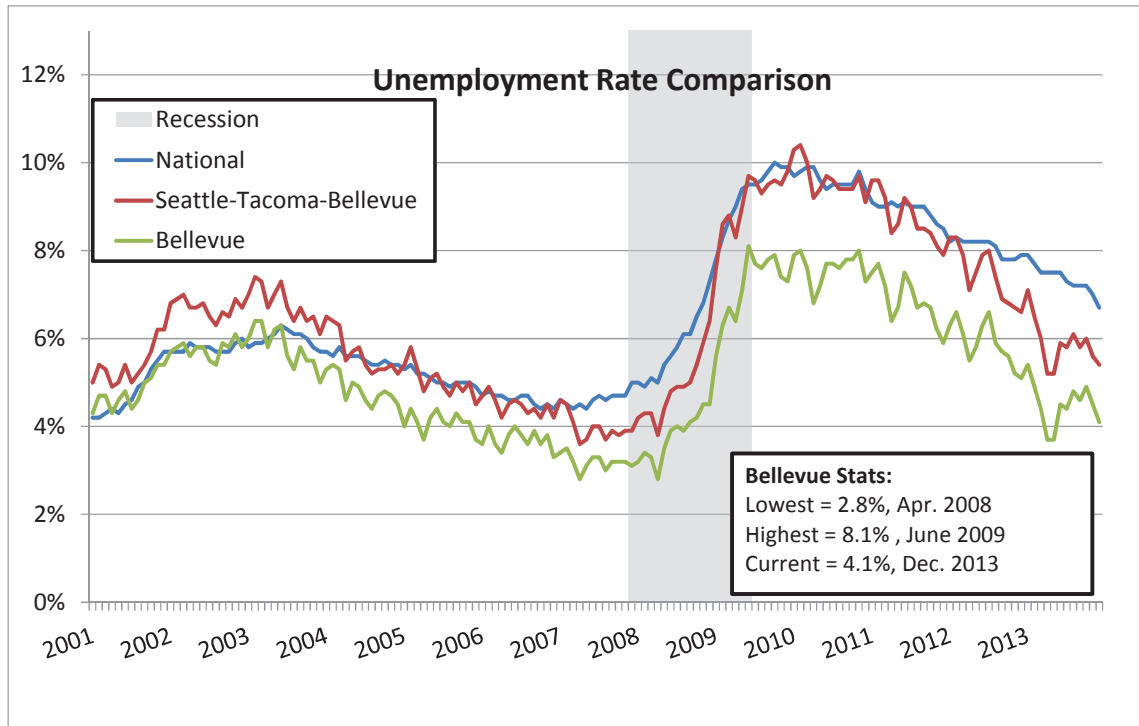
Bellevue home prices have rebounded much faster than the nation or even the rest of King County. Bellevue has almost regained all home value that was lost in the recession. Housing inventory has finally been worked off, and new construction has begun. Housing activity is influenced by the national school rankings, which increase a location's desirability and property values. Current average home values in real dollars are 5% below peak and, if home value forecasts hold true, the former peak in 2008 home values will again be reached in 2014.



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Employment in the region and in Bellevue has also fared better than the nation during and since the Great Recession. One reason for this is the strength of Boeing which was largely unaffected by the recession and, in fact, added jobs. Another factor is the higher-than-average educational attainment in the region. Since the beginning of the recession, workers with less than a high school diploma had a peak of 15% unemployment while workers with a bachelor's degree or higher had a peak unemployment rate of 5%, a 10% spread on a national level (*Source: Bureau of Labor Statistics*).

## Economic Outlook – March 24, 2014



Source: U.S. Bureau of Labor Statistics

Overall, the City's forecast assumes a modest recovery of tax revenue for the next few years, recognizing that the Puget Sound area's economy will continue to grow slowly as consumer demand returns. It should be noted that the above-mentioned potential global and federal risks are not factored into the forecast at this time.

The City's mix of revenue consists of Property Tax, Sales Tax, Business and Occupation Tax (B&O Tax), Utility Tax, user fees, state-shared revenue, as well as other smaller revenue sources. Each of these revenue streams grows at different rates, some very slowly like Property Tax (based on new construction), and some at a greater rate such as Sales and B&O Taxes. Due to these differing growth rates, the relative impact of one revenue stream that may be growing at a rate greater than the others is offset by other revenue streams growing at a much slower rate. Sales and B&O Taxes, combined, comprise 35% of total General Fund revenue and are very sensitive to economic conditions. These taxes are forecasted to grow between 4% and 5%, but when combined with all other revenue streams, which are less sensitive to economic conditions, are likely to grow at a rate slightly less than CPI. This means that for Sales and B&O Taxes to affect total revenue growth by 1%, Sales and B&O Taxes would have to grow by approximately an additional 3%.

Construction activity impact the City's revenue in several ways and needs to have special consideration due to its complicated nature.

- Construction in Washington is subject to sales tax, unlike many other states, the firms doing the construction are subject to B&O tax, and property tax revenue will increase by the value of the new construction regardless of a rate increase happens or not.
- Construction activity is highly volatile dependent on several market factors such as the real estate market as well as the overall health of the economy.
  - Large construction projects contribute to the highly volatile nature of construction derived revenue
  - Another factor is the availability of land and the proper zoning capable of accommodating large construction projects.
- A residual effect of large construction projects is the sales of these several hundred million dollar buildings well after construction has ceased. Companies that own large buildings often shift or change their portfolio dependent on going rate of returns and interest rates. During the recession real estate investment companies sold large office towers and other large developments that had unfavorable debt terms or rental income was not covering their debt service and then these same companies began buying as the recovery was taking place and interest rates were at historic lows and vacancy rate were on a downward trend. These sales transactions are subject to Real Estate Excise Tax which fund the City's capital improvement program.